MANDEVILLE IN THE TWENTIETH CENTURY

It is often stated that Adam Smith wrote to refute the doctrines of the mercantile school. It is Mandeville, however, who started the series of discussions which led up to the *Wealth of Nations.* No sooner had the *Fable of the Bees* appeared than replies began, each doing something to overturn the despised doctrine. What others failed to do, Smith succeeded in doing, and his book has been ever since a storehouse of arguments of economic orthodoxy. But doctrines though refuted loom up at each new national crisis with the same vigor and plausibility as had their originals. Is spending beneficial to trade is answered in the affirmative by as eager a host of popular writers as those of Mandeville's time. They would not say that the burning of London was good for trade, but they assume that expenditure for war makes a nation rich. They might not say that the sinking of a ship was beneficial, but if submarines sink a third of what we send abroad they would affirm that business was increased thereby. Even the worst do something for public good would now be interpreted to mean that German frightfulness makes business lively by making more work. Think of how rich we will make ourselves rebuilding the desolate regions of Belgium, North France, and Poland. Surely if work is the essence of trade there is plenty of it ahead of us. If we can keep up our spending and carry on the war at the same time, Mandeville is right. And so is he if we are made richer by the bonds we issue. Twenty billions of bonds we are told makes us twenty billions richer. "Buy a bond and pass it on" is a slogan equal in cogency to any of Mandeville's sayings. As the doctrine has been put in poetry, it deserves being perpetuated and placed in the same category as the *Fable of the Bees.* Here it is as written by Mr. Foley, an advertising expert. If this is not inflation, what is? Could paper money do more?

Buy a Bond and Pass It Along

Tom Robinson, the plumber, bought a hundred-dollar bond.
Though he truly loved his country, of his cash he sure was fond.
"I've bought because it's duty," said he to Doctor Jones.
"I've got to do my little bit to help the Allied loans."

The Doctor said: "I bought some bonds, then with them bought a car.
You owe me just a hundred." Said the plumber: "There you are."
And handed Jones his new-bought bond; then Jones paid off a debt
Of a hundred, to the furrier—before he could forget.

The furrier had bought some clothes—an honest man was he—
"Let's pay with Uncle Sam's good bond that helps to set men free!"
And so he paid. The clothier squared up an old account
With his jobber—so the bond went on, intact in its amount.

The jobber owed the grocer for the things his family ate.
Said he: "I'll pay in Libertys—you need no longer wait."
Then the grocer paid the butcher, who owed the carpet store,
And he in turn reduced his debt and helped along the war.

"I'd like to buy a dress now," said the carpet merchant's wife,
"A hundred-dollar one will do—with bargains stores are rife."
The modiste got the bond. Said she: "I know what I will do.
I'll have the bathroom fixed up fine and made to look like new."

And so, ere long, Tom Robinson, the plumber, had his bond
And no one in the country will be quicker to respond
When Uncle Sam's next loan appears. The moral of this tale
Is Buy a Bond and Pass It On—our country cannot fail.

Were this merely the voice of the street it might be overlooked, but it is what editors, orators, bankers, and officials are saying in a thousand forms. It is spoken as clearly as was the famous dictum of Jay Cooke during the Civil War that a national debt was a national blessing. We extol the bond and avoid the tax. War thus not only brings glory but also wealth. The more we spend the richer we are. These doctrines of the press and the platform also find an echo among the economists who, forgetting their traditions, join in the popular clamor. There are two causes for this. Economists have the same emotions as other people and find it hard to resist the cry of the street. They seek some compromise by which their feelings and their principles may be harmonized. Victory first and sound reasoning afterwards. Nor are economists free from class bias. Taxation they hate as it bears heavily on the class they represent. Where can one find a discussion of taxation that is not a tirade against the evils of taxation? This attitude degrades the scientific discussion of taxation into a plea for tax exemption. The only good tax is the one some one else pays.

It would be a useless task to flag some unknown scientist for these errors. The defense of economic theory must be made against those in high places or its cause will be lost. We cannot expect the man of the street or the rising host of young economists to

stand for economic integrity if our best known economists fail in the task which rightly belongs to them.[1]

One of the ways of discrediting an opponent is to assert the newness of his doctrine and thus to put on him the burden of seeming to overthrow established positions. Dr. Hollander, for example, finds that "the resistance to funding in war finance" was first explicitly stated by Mr. Pigou in 1916 and regards it "both as a melancholy example of scientific lapse and as a mischief-making error." What of this statement made not in 1916 but in 1808? "Were I a minister of Great Britain I would tax the country up to the fullest measure of public necessities and though the voice of obloquy arose from every corner of the empire I would brave it."[2] If this is not clear enough, take another quotation from the same author. "The important deduction to be made from this argument is that when the government defrays any of its expenses by borrowing, it does so by a method which is doubly more burdensome to the country than when it defrays the expense by taxes raised within the year."[3] Chalmers' view was restated by Mill in his third proposition respecting capital and has ever since been regarded as an essential part of economic theory. Dr. Hollander's position is a crude form of the quantity theory of money. About its assumptions I shall not argue, because the issue lies at other points. This theory belongs to the group of which the wage fund, the law of diminishing returns, and the doctrine of laissez faire are notable instances. They are built on the assumption that the economist can sit in his study and know what is going on outside, without looking out. When economists become pragmatic, they define inflation and study its manifestations before they theorize about it. Is Mr. Foley's position sound, and is it or is it not the popular method of representing the possibilities of bond issues? Are we trying to do business as usual and buy bonds without saving, or is economy not only preached but practiced? What evidence have we that popular savings correspond to the amount of bond issues? Are the major part of the national bonds still held by the banks or have they passed into the

[1] Examples of what I regard as unsound reasoning may be found in recent papers read before the American Academy of Political and Social Science, as "Do Government Loans Cause Inflation?" J. H. Hollander; "Loans vs. Taxes in War Finance," E. R. A. Seligman, *Annals of the American Academy,* Jan., 1918.

[2] Thomas Chalmers, *National Resources,* p. 306.

[3] *On Political Economy* (1832), p. 492.

hands of the investing public? From these facts we may learn what inflation is and how to test its presence. The decision does not depend on the quantity theory of money nor is it a deduction therefrom. Inflation is an overestimate of present powers to consume. It is a rise in prices without a corresponding rise in the physical costs of production. If the resulting state is not to be called inflation it at least deserves study. There is plenty of evidence of rising values, but none of an increase of physical costs. The efficiency of labor is greater than it ever was. This means more free income but it does not indicate an increase of saving. What comes easily goes with even greater ease. I can find no evidence that the American people have as yet materially reduced their consumption of goods. Most of the items which I have been able to check show increases and the news summaries reveal the same tendency. Dr. Hollander must show facts as well as make assertions.

Professor Seligman is not so bold a theorist as Dr. Hollander, but he has an overconfidence which leads him to give his opponents the long end of the lever and thus to deprive his argument of its plausibility. He admits that the objective costs of the war must be borne by the present. War consumes commodities and demands service. Both must be met by present exertions. But he claims the real costs of the war are the subjective losses which it imposes. These he claims can be postponed, and thus a part of the burden may be passed on to the future. In recent years an emphasis has been placed on the subjective elements in economic theory. I have done my part in this work and do not wish to retract what I have said. But Dr. Seligman neglects the important background to all theorizing. The subjective is not economics but psychology. We use psychology not to reach a final settlement of economic doctrine, but to handle problems of which the objective data are still unknown. Take, for example, early discussions of the consumption of wealth. At that time no elaborate statistical data of the food supply were at hand. The only tests were crude measures of our eagerness for food. Much was thus added to our knowledge of the standard of living. But such reasoning, valuable as it is, cannot be put in opposition to the facts we now have as to the necessary elements in national nurture. When we have the facts our psychologic estimates go by the board. Knowing how many calories are needed to support an efficient worker, his likes and dislikes are a matter of no mo-

ment. If he suppresses his feelings and lives as he should he prospers. If his psychic antipathies are too strong to permit an adjustment to the new conditions he must be regarded defective. Our feelings are our best standards so long as objective data fail, but to put feelings in opposition to fact is to oppose knowledge.

It would be interesting to have Dr. Seligman state just what these subjective costs are which he thinks can be postponed. Only when this is done can we estimate their value. Were they stated they would be found to be feelings which we compensate in the future at our peril. One of the benefits of the war, perhaps its greatest compensation, is the removal of disadjustive feelings—those which in a cruder civilization were of use, but which now have become bars to further progress. When we see the change which increasing knowledge has brought in regard to liquor we may hope that many more changes are in sight where objective fact will displace subjective estimate. The time has come for economists to base their arguments on known facts. When they do we shall hear nothing more of repaying in the future the burden of subjective cost borne today by those whose estimates of their welfare do not tally with present reality. Only those can be happy whose ideals, concepts, and feelings are grounded on the world about us. It is we who should adjust ourselves to nature and not nature that must change to meet our whims.

We now come to Professor Seligman's main thesis. Must the costs of the war be borne by the present, or can the burden be shared with the future? The answer to this question depends on the meaning attached to the terms. How long a period is the present and how far off is the future? To make the terms definite, I shall assume that the present means the period in which the present holders of property must bear the burdens imposed and that the future means the time when the next generation assumes the burdens of taxation. The present then means the period of the war or at least the next two or three years. The future is twenty or more years distant. Thus stated, we have a problem which may be solved. It is, however, not a solution to show that the present may burden the future. We do this by every false move we make. It is one thing to burden and quite another to so burden that the present may obtain some relief. It is only the latter case which is worth discussing. The illustrations used by Dr. Seligman relate to the replacement of capital and to over-

strain imposed on the laborer. In these cases he has not examined the evidence as carefully as he should. It is possible to delay the replacement of a plant, but this brings with it immediate losses to national efficiency if the plant is essential to the prosecution of the war. The railroads have been sparing for the last few years in replacing their rolling stock and in enlarging their trackage but today we find they have placed a huge burden on the present by their false economy. We suffer from high prices in a way we could have avoided if the railroads had enlarged their rolling stock as they should. What is true in this case is equally true in every essential industry. The lesson of the war is that victory comes by industry behind the lines more than by those in the trenches. Enormous quantities of fixed and circulating capital are thus demanded beyond the normal needs of times of peace. Equally true is the limit to the exploitation of labor. For a few weeks a worker can stand an overstrain, but the lesson of the war is that the hours of work must be shortened and labor conditions improved to get the maximum efficiency from laborers. The opposite of Dr. Seligman's contention is, therefore, true. To minimize its burden the present must not only bear the expense of the armies but it must reduce its consumption still further so that fixed capital may be increased and labor better provided for. Any attempt to scrimp in these items increases present burdens through national inefficiency, and may even defeat the object for which the war is waged. If any expenditure is a necessity, that expenditure must be increased. The burden of the war must therefore fall on present consumption, which must be reduced by a sum equaling the cost of military expenditure plus that demanded by the increase of capital and the better care of labor. Comforts may be delayed but not necessities.

Professor Seligman's second point relates to the use of credit which to many is an obscure phenomenon. In some mysterious way it can, they think, increase the efficiency of capital and labor. It may even, many contend, be a substitute for them. But if carefully defined terms are used, credit becomes a simple matter with advantages and limitations which may be clearly defined. The basis of credit is the period ensuing between the time when work is performed and that when the object produced is consumed. This may be measured by the stock on hand at a given moment or by the time the money of consumers lies in banks before being used. Bankers take advantage of this delay and loan their de-

positors' money on short-term notes. A second form of credit comes from the irregularity of business enterprise. There are few occupations but have slack seasons when all the capital is not in use. Deposits are then increased and the banker may use these funds in places where there is a present urgency. Both these forms of credit are useful, but it should be noticed how short is the delay in each case. Legitimate banking is restricted to commercial paper running not more than ninety days, while long-term credits should be forbidden by law. It is what the law should not permit the banker to do in his regular business which Dr. Seligman advocates. To treasury notes having a short time to run there is no objection provided they are taken up at maturity. But long-term bonds cannot fulfil these conditions. Tying up the consumer's money, they prevent him from using it to meet current expenses. Such a use of credit is sure to bring disaster not only to the future but also to those of the present who share its prosperity. Credit is thus a temporary means of delay but not an available resort for those who would shirk present burdens at the expense of those who come after. It would be more truthful to call the present a cash economy than to call it a credit economy. The vast bank deposits show that the consumer is forehanded and wants to consume instead of rushing ahead with credit expenditures. He knows that cash payments reduce present burdens. To work and then enjoy creates economies which to enjoy before working never produces. The nearer we come to eliminating credit, except in the instance noted, the better for the nation. Would our public affairs were managed with the acuteness with which we manage our own accounts.

To make this point clear I must question another of Dr. Seligman's statements. All credit, he says, rests on a substratum of cash. The fact, however, is that cash rests on credit and not credit on cash. Given a certain quantity of delayed consumption on the part of consumers and the quantity of credit is fixed. Then it becomes a matter of experience how much cash is needed to meet the exigencies which arise from consumers' demands. If business were regular and the moods of consumers unchangeable, little cash would be required. The receipts and outlays of each day would be unvarying. But experience shows that this is not the case. There are fluctuations in demand which sometimes rise to a third of the deposits while again they fall so low that call money has a nominal cost. Bank reserves have a relation to these

irregularities. They are the result of credits and not their cause. We do not get at their source by regarding them as a monetary phenomenon. They are primarily an index of delays in consumption, and grow not as consumers fall behind in their payments and thus create debts but as they are forehanded and wait after production for some favorable opportunity to invest. Odd as it may seem, bank credits grow with cash payments and not with the increase of debt making. They are advances by the consumer to the producer, not cash advances by banks to those consumers who lag in their payments. When this is seen the benefits and limits of bank credits become apparent. The length of particular credits cannot safely exceed the average delay of the consumer in making purchases. We are learning that we must go behind monetary statements and actually measure the goods and food in stock. What food controllers and business controllers do in time of war to avoid exorbitant prices will be done as a regular matter after the war. We shall keep our eyes on the consumer and limit the banks to their proper place.

To focus the attention on the essential, we must contrast the agencies which promote consumption and those which delay it. From lack of a careful analysis we are apt to confuse the two by assuming that the banker does both. This may be true of individual bankers, but if so they use two distinct agencies to secure their ends. Promoting business is done not through banks but through newspapers, advertising, and salesmen. It is an art distinct from banking and demands men of other capabilities. The slogan of men who want business is to advertise, and to do this successfully they must control the newspapers and other agencies which form public opinion. A man who wants more business does not go to a bank and ask for extension of credit. He advertises, gets business, and then goes to the bank for means to enlarge his plant. If he gets consumers to buy before the bank enlarges his credits, the action of the bank is legitimate even if it promotes unproductive consumption. The banker has the consumer's money. He does legitimate business if he loans this money to those from whom the consumer will ultimately purchase. Suppose a banker loans his deposits to plowmakers when his farmer depositors mean to buy automobiles or that he loans the funds of his city depositors to housebuilders when they mean to buy pianos. In each case he would be misdirecting the wealth of the country with the result that production and profits would be re-

duced. He should loan to those who have business and not to those who ought to have business. The consumer is thus the ultimate director of production, and the people who guide him are those who set the pace in business affairs. So long as they control public opinion the banker is powerless to resist the overconsumption which they encourage. They induce consumers to believe they are wealthier than they are, and that their funds can be used in two or more ways at the same time.

Mr. Foley's scheme of passing bonds along is not the only means of promoting overconsumption. A man may keep his bond and yet, assuming it to be cash instead of wealth already spent, he may order a new bathtub for the home, a new dress for his wife, or any other expenditure his newspaper reading encourages. It is the belief that he is wealthier than he is which leads to these indulgences for which not the banker but the advertising expert is responsible. Why should we not spend when we are taught our money can go in several ways at the same time? Why not inculcate patriotism in our children by letting them buy savings stamps and then use the stamps to buy candy? Or why not buy a bond and then exchange the bond for a suit of clothes, an automobile or a piano? If one wishes to be doubly generous, why not buy a bond and then give it to the Red Cross or to some local charity? Patriotism, charity, and pleasures are thus combined.

Criticism, however accurate, is misplaced unless it is accompanied with positive views. The problem of loans and taxation is becoming the test of two systems of economics as diverse in their aims as the mercantile system and that of Adam Smith. A compromise between Smith and a mercantilist is impossible and so is a tax system partly resting on bonds and partly on taxation. As principles differ so also do the presuppositions on which the theory rests. The problem to be solved is, how can a nation with an annual surplus of three billion dollars spend ten billions in a year? It is immaterial whether this surplus is three or five billions or the expenditure ten or fifteen billions. If the surplus exceeds the expenditure whether by one sum or another, all that Dr. Seligman says holds true. But in the reverse case if the expenditure exceeds the surplus the importance of his discussion is reduced and some new theory is demanded to meet conditions which older economists were not compelled to face. Despite the sorrows and laments of the taxpayers the world has never before spent in a given epoch more than it produced. How can nations

do this is a question seriously asked and which must be answered with a like seriousness. There is but one reply possible. The daily consumption of the people must be reduced to correspond to the excess of expenditure over the annual national surplus. Any subterfuge leads to a worse deficit and adds to the danger of a failure of national aims. Bonding is a device of this character. It induces people to think they can grow rich on the unproductive expenditures of the state. Consumption is expanded when it should be contracted. A shortage of goods follows and then come high prices, which make people believe they are more prosperous instead of less so. Taxation if wisely laid would bring order out of chaos and not only exempt future generations from the burdens of war but also lighten those of the present.

In essence, the burden of the war is the excess of national expenditures over national surplus. To this amount the consumption of the people must be reduced. If expenditures are, say, seven billion dollars, consumption should be reduced by this amount and the saving turned over to the government. The account is thus squared in each year and the war is paid for but once. But if, instead of adopting this simple solution, the people try to avoid the burden through loans, what happens? The seven billions needed does not come down out of the clouds. It cannot come out of the annual surplus because this sum is the excess of expenditure above the annual surplus. There is only one way out. The government must cause or permit a rise of prices which increases the profits of individuals. It then borrows of these profiteers the seven billions it needs. Dr. Seligman thinks it suicidal to take seven billions directly and yet the policy adopted takes double the amount from the people's pockets. Here are the figures showing what happens. The agricultural products of this year are valued at twenty-one billion dollars. Practically the same quantities five years ago were worth only ten billion dollars. An able economist estimates that it takes now fifty billion dollars for the American people to secure what they obtained for thirty billions before the war. This shows that the people are paying two dollars in increased prices for every dollar the government benefits by loans. Ten billions have dropped somewhere on the way. This tallies with another statement made by an equally eminent authority who says that during the past year five billion dollars have remained in the hands of corporations as undeclared dividends. If this is true, it will not be difficult to

discover where the other five billions have gone. Not only have the people paid a double amount in consumption taxes but the capitalist has to pay it again. Someone has stated as a law that as the amount of government bonds increases the value of corporation securities decreases. Three payments of war expenses are thus the least which present methods of bonding permit, *two of which are in the present.* The consumer pays, the capitalist pays, and then one or both must pay again at the maturity of the bonds. If bondholders are to be exempt until the bonds are paid each one may figure for himself what future taxation will demand of him. And the misery of the situation is that this solution is the only one which has an opportunity to be used. Would that theorists were given a chance to test these claims! Practical men though they sit in high places and have imposing funerals lie in obscure graves.

I regret the difference which compels me to dissent from Dr. Seligman's position. Because of the popularity of views like those of Mr. Foley, it is important that economists present a sane program. So long as the ability of the nation to pay for the war at once and but once by taxation is in question, such an agreement is impossible. The second point of equal importance is that a higher rate of interest must be offered. Interest rates are four per cent too much or four per cent too low. They are too much if they are a bonus to those who profit by war expenditure. They are too low to arouse the thrift instinct in those who now spend as fast as they earn. As it is, war bonds are war profits and induce free spending instead of curbing it. No part of Dr. Seligman's argument justifies the statement that the full payment of war expenses by taxation would be suicidal. It belongs to a group of assumptions made by business men who have a defective view of their own welfare. An opposition to high wages, high rates of interest, to government restraint, and to taxation is the outspoken expression of this crude antipathy. Economists are not likely to adopt this code as a whole, but they are not free from the bias which this attitude creates. They overestimate the disadvantages which economic transformations bring and underestimate their gains. I doubt if their fears will be justified by the results; but even if change proves damaging, it will do so only because they oppose changes which must come.

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